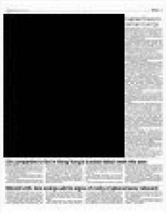

09 JUL, 2024

Deciphering the data centre thematic play

The Star, Malaysia

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Who are the real beneficiaries of the boom?

STOCK MARKET

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>
> Ian Yoong Kah Yin

PETALING JAYA: As numerous listed companies and their financial advisers try to carve out investment themes of them being a beneficiary of the data centre (DC) boom in Malaysia, caution needs to be taken.

For one thing, DCs have been around for more than 20 years and so any company that is now saying it is able to do something for DCs, the question is, has it been doing it before?

"DCs typically have an established and global supply chain for their equipment and IT components. It doesn't matter to them where you are based.

"So if you are now saying you can build a component for data centres just because a number of such facilities are being set up in Malaysia, the question is, have you been able to do that before?

"If not, then there is little chance of you being able to do it now, just because we have a DC boom in Malaysia," explained Gary Goh, the chief executive of DC advisory firm Sprint DC Consulting.

Even so, Goh remains bullish on the prospects of the real beneficiaries of the DC boom in Malaysia.

These include land owners who are able to sell the land to the DC operators, the contractors being given jobs to construct parts of the DC buildings and even energy providers like Tenaga Nasional Bhd (TNB) and their subcontractors.

The local DC market, according to a report, is forecast to grow at a six-year compounded annual growth rate of 13.9% from US$1.8bil in 2023 to US$4bil by 2029.

The cost of constructing a DC in Malaysia ranges between US$6.7mil and US$10mil per megawatt (MW), which is lower as compared to Singapore and Indonesia's capital Jakarta, but costlier than Thailand and the Philippines.

The big players in the construction sector, such as Gamuda Bhd and Sunway Construction Group Bhd, have secured a total of at least RM2bil worth of DC contracts.

Meanwhile, IJM Corp Bhd clinched its maiden DC job recently when it was awarded a RM332mil contract to design and construct Block 2 of the Iskandar Puteri Data Centre for TM Technology Services.

In the property space, several property developers have sold their land for the development of DCs. These include low-profile Johor-based Crescendo Corp Bhd and government-linked companies like UEM Sunrise Bhd and Sime Darby Property Bhd.

Goh, who assists foreign DC operators looking to set up operations in Malaysia, also noted that there were a number of landowners thinking that their land can be suitable for a DC.

"But it is not so easy. There are many considerations to be looked into, such as the cost of ramping up energy and resource infrastructure there, the surrounding neighbourhood as residential ones could voice out their disapproval to be close to DCs.

"This is why a study needs to be done, and this is what we do," he told *StarBiz*.

The DC theme, which has been playing out for the first half 2024, has also seen a spillover effect onto mid and small-cap stocks. Does the rally still have legs?

Research firms like JP Morgan think so but advocate staying selective in the DC space, preferring a pick-and-shovel strategy, which is investing in companies that provide necessary equipment and services for the industry.

CGS International (CGSI) said the DC ecosystem can be divided into four main categories – location or land; basic infrastructure comprising construction, materials, mechanical and electrical (M&E); hardware such as data storage systems and solutions, and lastly the power and connectivity factor.

"In our view, from a retail investor's/trader's perspective, these are the four key categories that are most relevant for selecting/screening potential beneficiaries of DC-related contracts and/or services," the research firm said in its June 30 report.

It said while tech/hardware-related companies will remain as DC beneficiaries over the long run, the construction and property sectors are the earlier or direct beneficiaries of the DC value chain.

According to CGSI, the share prices of technology, M&E solutions, and cooling systems providers have surged about 144% year-to-date (y-t-d) on average, at a trailing price-earnings of 33.4 times.

On the other hand, it noted that valuations of construction/engineering services players with exposure to DC construction are at a more palatable average of 22.4 times price-earnings.

The current DC play is reminiscent of the glove mania following the Covid-19 outbreak.

Investor Ian Yoong Kah Yin reckons that when the DC theme implodes, and it will he believes, share prices of listed companies that profit from DCs will fall too.

He points to one rubber glove company that was profitable for the past five years but saw its share price fall sharply in tandem with loss-making rubber glove manufacturers. Investors, he said, tend to throw out the baby with the bath water.

He thinks many of the share price outperformance of these wanna-be companies jumping on the DC and artificial intelligence or AI bandwagon could fizzle out by 2025.

With DCs requiring tremendous amounts of electricity, Yoong is positive on TNB, Malakoff Corp Bhd and other listed electricity producers.

He said the preferred energy source for DCs is renewable energy and he expects more electricity supply agreements with DC companies to be signed over the next 12 months.

"DCs will drive electricity demand. Domestic demand for electricity recorded a new high of 20,028MW in April 2024 with strong commercial demand due to DCs coming on stream in the first quarter of 2024," said Yoong, who thinks the share price outperformance of TNB and Telekom Malaysia Bhd, which is one of the largest DC operators in Malaysia, could see the FBM KLCI move up to 2,000 points by 2025.